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In the Supreme Court of the United States

OCTOBER TERM, 1969

No. 64

ELMER E. MILLS AND LOUIS SUSMAN, PETITIONERS

v.

THE ELECTRIC AUTO-LITE COMPANY, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is submitted in response to the Court's order of April 21, 1969, inviting the views of the United States.

OPINIONS BELOW

The opinion of the district court (App. 675–684)[1] is reported at 281 F. Supp. 826.[2] The opinion of the court of appeals (App. 1001–1014) is reported at 403 F. 2d 429.

[1] "App." references are to the printed Appendix in this Court.

[2] The district court's Findings of Fact and Conclusions of Law upon which summary judgment was granted, its order expunging one of the conclusions of law, and its earlier unreported opinion specifying facts appearing without controversy are set forth at App. 441–454, 684–691.

JURISDICTION

The judgment of the court of appeals was entered on November 25, 1968 (App. 1015). On February 21, 1969, Mr. Justice Marshall extended the time for filing a petition for a writ of certiorari to March 10, 1969. The petition was filed on the latter date, and was granted on April 21, 1969. 394 U.S. 971. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

This brief will discuss the following questions, which it is believed are comprehended by the questions that petitioners present:

1. Whether, in a suit challenging a corporate merger on the ground that the proxies by which the stockholders consented thereto were obtained through materially misleading statements, the fairness of the terms of the merger is a defense to the action or merely bears on the relief to be awarded.

2. Whether a determination that the federal securities laws have been violated by misleading solicitation of proxies required to authorize a corporate merger entitles solicited stockholders, suing as a class and derivatively on behalf of their nonsurviving corporation, to an award of reasonable litigation expenses, past and prospective, irrespective of any other relief that might subsequently be deemed appropriate.

STATUTE AND RULE INVOLVED

Section 14(a) of the Securities Exchange Act of 1934, 48 Stat. 895, as amended, 15 U.S.C. 78n(a), provides:

> (a) It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 781 of this title.

Section 29(b) of the Securities Exchange Act of 1934, 48 Stat. 903, as amended, 15 U.S.C. 78cc(b), provides in pertinent part:

> (b) Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule or regulation * * *.

Rule 14a–9 of the Securities and Exchange Commission Rules, 17 CFR 240.14a–9, provides in pertinent part:

> (a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading * * *.

STATEMENT

Petitioners are minority shareholders of respondent Electric Auto-Lite Company ("Auto-Lite"). They instituted this action in the United States District Court for the Northern District of Illinois on June 26, 1963, against Auto-Lite and two other corporations, Mergenthaler Linotype Company ("Mergenthaler") and American Manufacturing Company, Inc. ("American"), on behalf of Auto-Lite, derivatively, and on behalf of its minority shareholders as a class. The original complaint sought, *inter alia,* to enjoin the voting of all proxies obtained by the Auto-Lite management in favor of a proposed merger of Auto-Lite and Mergenthaler on the ground that the solicitation of the proxies was materially misleading, in violation of Section 14(a) of the Securities Exchange Act of 1934 ("Act") and the Securities and Exchange Commission's Rule 14a–9 thereunder (App. 3–24). Subsequently, after the merger was authorized at a

meeting of Auto-Lite stockholders and became effective, an amended complaint was filed in February 1964, seeking to have the merger set aside, on the ground, in part, that the proxies solicited by the Auto-Lite management and voted by it to authorize the merger were void because of the violations charged.

The challenged proxy statement proposing the merger of Auto-Lite and Mergenthaler was mailed to the stockholders by the Auto-Lite management on May 29, 1963 (App. 27–134). Before the merger, Mergenthaler owned 54 percent of the outstanding shares of Auto-Lite common stock, and the remaining 46 percent was held by 8,987 other shareholders (App. 1004). Thus, in order to achieve the two-thirds vote required to approve the merger, the votes of minority shareholders holding approximately 13 percent of the outstanding shares were needed. The merger was in fact approved by votes representing 82 percent of the common stock (App. 1005).

The proxy statement consisted of 108 pages. At page 23, under the caption "Principal Holders of Securities," it contained a percentage breakdown of the principal shareholders in the companies involved in the merger. This showed that on May 1, 1963, Gurdon W. Wattles, who was president and a director of American Manufacturing Company, Inc. ("American"), as well as chairman of the board and a director of Mergenthaler and chairman of the executive committee and a director of Auto-Lite, owned approximately 34 percent of the voting stock of American, that American and Mr. Wattles in the aggregate owned approximately 33 percent of the stock of Mer-

genthaler, and that Mergenthaler owned approximately 54 percent of the outstanding common shares of Auto-Lite (App. 51). It was further stated that no other person owned of record, or was known to own beneficially, more than 10 percent of the stock of Mergenthaler or of the common stock of Auto-Lite (App. 51).

On page two of the proxy statement in boldface and larger type than was used generally in the text, was the statement: "The Board of Directors has carefully considered and approved the terms of the merger and recommends that the shareholders vote to approve the plan of merger" (App. 30). On the same page, there appeared in regular type under the heading "Reasons for Merger" the following statement: "After a thorough review of all factors involved, both Boards of Directors are of the opinion that the merger would be mutually beneficial to the Constituent Corporations and their respective shareholders" (App. 30).[3] Mergenthaler's ownership of 54 percent of the Auto-Lite common stock was also mentioned on that page.

Count II of the complaint[4] charged that the sole purpose of the merger was to effectuate a "fraudulent plan" conceived by American and Mergenthaler to

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[3] On page three of the proxy statement, the following explanation appeared in regular type under the heading "Basis of Merger": "The Board of Directors of Electric Autolite believes the plan of merger to be fair and equitable to the shareholders of Electric Autolite; the Board of Directors of Mergenthaler believes the plan of merger to be fair and equitable to the shareholders of Mergenthaler" (App. 31).

[4] Count I of the three-count complaint alleged common law fraud; Count III alleged that the merger was ultra vires under Ohio law (App. 163–177, 180–183).

take over Auto-Lite's business at a loss to Auto-Lite, that no Auto-Lite director was independent and free from the control and domination of Mergenthaler, and that the proxy statement concealed this lack of director independence from the Auto-Lite shareholders (App. 170, 173, 178).

The district court, in an unreported memorandum opinion and order, held that the controlling issue was whether as a matter of law "the proxy statement disclose[d] to the shareholders of Auto-Lite all of the material facts with respect to the control of the Board of Directors of Auto-Lite by Mergenthaler and American Manufacturing so that the shareholders could bring their own independent judgment to bear on the directors' endorsement of their merger proposal" (App. 446–447). It ruled that the proxy statement violated Section 14(a) and Rule 14a–9 because it failed "to disclose * * * that members of the Board of Directors of Auto-Lite were nominees of Mergenthaler" (App. 448).[5] In a subsequent opinion granting, as to Count II of the complaint, the plaintiffs' motion for summary judgment, the court further held that "[w]here the accused proxy material is not merely 'randomly present' in the context of the transaction, a causal relationship is established as intimate and direct, particularly where a merger is involved. * * * Such a direct causal relationship [between the proxy material and the merger] exists in the present case" (App. 681).

[5] The district court subsequently stated that the action taken in that memorandum opinion and order "was a specification of facts appearing without controversy relating to Count II of the amended and supplemental complaint, pursuant to Rule 56(d) of the Federal Rules of Civil Procedure" (App. 464).

The court of appeals agreed that the proxy solicitation material violated Rule 14a-9. It held that "as a matter of law the proxy statement failed, in connection with the advice tendered by the board, adequately to bring out the relationship between the board members [of Auto-Lite] and Mergenthaler. This * * * was an omission of a material fact" (App. 1011). The court further explained that "in light of the [Auto-Lite] board's statements recommending and giving opinions favorable to the merger the failure to give similar emphasis to the relationship with Mergenthaler was the omission of a material fact necessary to make the laudatory statements not misleading" (403 F. 2d at 436).*

The court of appeals disagreed, however, with the district court's holding on the issue of causal relationship, ruling that the granting of summary judgment with respect to this issue was improper because "there is an issue for trial with respect to the causal relationship between the deficiency in the proxy statement and the merger" (App. 1012). The court of appeals stated that because it was too late to prevent the merger "[t]he court must now determine in retrospect whether the unlawful act caused some inequity or damage which the court should relieve or redress";

* The court of appeals pointed out that in the course of a proceeding before the Commission, in which American had sought and obtained an exemption from provisions of the Investment Company Act of 1940 and which was terminated two months before the solicitation of the proxies herein, American had made a statement that tended to show "that the management of American selected directors for Mergenthaler and Autolite, and that Autolite was under the control of American" (App. 1008–1009).

that "evidentiary material tending to show that the merger has merit and the terms were in fact fair and equitable to the minority shareholders * * * does bear on the cause question"; and that, consequently, it may be possible for the defendants "to satisfy the court, by a preponderance of probabilities, that the merger would have received a sufficient vote even if the proxy statement had not been misleading in the respect found" (App. 1011–1013). The court held that "the burden of persuasion" on the issue of causal relationship would be

> on defendants, who are responsible for the violations, but if they are able to carry the burden, there would be no sound basis for disruption of the merger or other relief. We do not consider that the policy of the '34 act requires the court to unscramble a corporate transaction merely because a violation occurred [App. 1013–1014].[7]

The court of appeals reversed the judgment and ordered that "the costs * * * be taxed in favor of defendants" (App. 1015).

INTRODUCTION AND SUMMARY OF ARGUMENT

Where stockholders have established that a proxy statement sent out to solicit votes to authorize a merger was materially misleading in violation of the Commission's proxy rules, they have proved their cause of action, and it is unnecessary for them to

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[7] The district court had reserved for subsequent determination, pursuant to the recommendations of a master, the issue of appropriate relief (App. 683–684). The court of appeals found the reference to the master inappropriate in the circumstances (App. 1014).

prove, in addition, that the merger would not have been approved if the proxy solicitation had not been misleading.

If such a violation of the proxy rules has been established prior to the corporate meeting at which the proxies were intended to be used, a resolicitation prior to the meeting will normally serve to undo any harm. Where, however, the violation is not discovered until after the meeting [8] or for some other reason preliminary injunctive relief has not been obtained,[9] we agree with the court of appeals that, contrary to the petitioners' contention, proof of the violation does not necessarily require that a merger approved at the meeting through voting of the proxies and subsequently fully consummated must be undone (although such relief is available to the court). A court of equity may properly conclude that, in the circumstances of the case, undoing of the merger would be contrary to the best interests of the parties or of innocent third persons and, therefore, unwarranted. It would normally be necessary, however, to grant other appropriate relief to those who have been harmed by the violation.

Where, as here, the misleading aspect of the proxy solicitation did not relate to the terms of the merger, the stockholders should be entitled to monetary relief only to the extent that they can show they suffered

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[8] Cf. *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432–433.

[9] Preliminary injunctive relief is sometimes conditioned on the plaintiffs' providing a bond, the expense of which may be a deterrent. Cf. *Electronic Specialty Co.* v. *International Controls Corp.*, CCH Fed. Sec. L. Rep. ¶ 92,342 at 97,633 (C.A. 2, January 24, 1969).

pecuniary damages from the merger. If assets and operations of the merged companies have become so intermingled that it is impossible to ascertain whether such injury resulted, the appropriate relief to be accorded, if any, will depend principally on whether the terms of the merger were fair.

The holding of the court below that a showing of "causal relationship" between the proxy violation and the merger is a necessary part of the plaintiffs' cause of action has the unfortunate ancillary effect of denying to stockholder-plaintiffs who can establish a violation of the proxy rules assurance that their reasonable litigation expenses will be reimbursed. Once the violation has been established, the plaintiffs' expenses, both in establishing the violation and in attempting to show unfairness of the merger, should be borne by their corporation; otherwise, private actions under the Commission's proxy rules, which are a necessary supplement to the Commission's enforcement activity, would be seriously inhibited.

ARGUMENT

I. FAIRNESS OF THE MERGER TERMS IS NOT A DEFENSE TO A PRIVATE ACTION COMPLAINING OF MATERIALLY MISLEADING SOLICITATION OF PROXIES WHICH AUTHORIZED A CORPORATE MERGER, BUT IS A RELEVANT CONSIDERATION IN DETERMINING APPROPRIATE RELIEF.

1. Having established a violation of the antifraud provisions of the proxy rules, the plaintiffs should be deemed to have proved their cause of action. *J. I. Case Co.* v. *Borak,* 377 U.S. 426, 433. Thus, as the court of appeals recognized (App. 1011), where a material violation of the proxy rules has been established

before the meeting at which the proxies were intended to be used, courts will enjoin the voting unless there should be resolicitation.[10]

We disagree with the apparent conclusion of the court of appeals that, even where a timely complaint is filed (as was true here), the plaintiffs would have no case, notwithstanding the violation, if the defendants were to show that there probably would have been a sufficient vote to approve the merger had there been no defect in the proxy statement. There are two principal reasons for our disagreement with the court of appeals on this point.

First, it is wholly impracticable to determine directly whether or not the result of the shareholder vote would have been different if the improperly omitted information had been included in the proxy statement. The court of appeals apparently recognized this[11] and focused the inquiry, instead, on the fairness of the merger—based on an apparent assumption that, if the merger were in fact fair, it would have been approved by the shareholders in response to a proper solicitation of their proxies. By thus apparently making the plaintiffs' rights wholly dependent on whether the merger was fair, the decision erroneously insulates a category of proxy violations from private redress. For, no matter how outrageous the misrepresentations in

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[10] *Studebaker Corp.* v. *Gittlin*, 360 F. 2d 692, 698 (C.A. 2); *Willoughby* v. *Port*, 182 F. Supp. 496 (S.D. N.Y.) affirmed as modified *per curiam*, 277 F. 2d 149, 150 (C.A. 2); cf. *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F. 2d 540 (C.A. 2).

[11] It stated that actual "[r]eliance [on the misleading material] by thousands of individuals, as here, can scarcely be inquired into" (App. 1013, n. 10).

the proxy material soliciting votes to approve a merger, the shareholders would have no cause of action if the terms of the merger were found to be fair. Such a result—particularly if carried over to the Commission's enforcement actions, as it seemingly would be if the fairness of the merger were regarded as a defense to a suit for violation of the proxy rules—unjustifiably subverts the proxy rules. Under those rules, shareholders have an independent interest in full and fair disclosure irrespective of the underlying fairness of the merger. They are entitled to receive an accurate proxy statement which is adequate to enable them to exercise their own informed judgment as to the desirability of the merger.[12]

Second, as discussed more fully in Part II, *infra*, there is the practical problem that, if the fairness of the merger were a complete defense, small stockholders would be discouraged by this additional risk in the litigation from attacking allegedly defective proxy statements. This would seriously impede private enforcement of the proxy rules.

Accordingly, we agree with the petitioners that the causation requirement is satisfied if the proxy solicitation itself, rather than the particular defect in the proxy material, was an essential link in the chain of events that brought about the merger. Causation under

[12] Even where the terms of a proposed merger appear to be fair, the outcome necessarily involves uncertainties. The business and operations of the two companies may not fit together as well as was hoped. Shareholders might wish to avoid such risks by voting against a merger unless it appears to them to be affirmatively beneficial rather than merely fair. Moreover, a stockholder may prefer independent operation rather than merger into another company even on a fair basis.

this standard is present here, since some of the votes solicited by the defective proxy material were necessary in order to obtain the required shareholder approval of the merger.[13] In these circumstances, a plaintiff need show only that the defect in the proxy statement was sufficiently material that it might have influenced the vote of a reasonable shareholder.

In the present case, there might well have been stockholders who accepted the advice of their directors in favor of the merger without studying its details, but who would not have accepted that advice without independent study if they had been adequately informed that there was a question as to the disinterestedness of the directors. Since there is no practical way to measure how many votes were affected, the doubt should be resolved in favor of those against whom the violation was directed and for whose protection the statute was designed, rather than in favor of the violators. *Eastside Church of Christ* v. *National Plan, Inc.*, 391 F. 2d 357, 362 (C.A. 5).[14] The objective test suggested above is not only practical and workable but will serve to

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[13] It is unnecessary in this case to resolve the question, presented in *Barnett* v. *Anaconda Company*, 238 F. Supp. 766 (S.D. N.Y.), of causation in the situation where the management has enough votes to approve the transaction, whichever way the minority votes. Even in that situation, however, if it is necessary, for legal or practical reasons, to solicit the proxies of minority shareholders, proxy solicitation could be found sufficiently related to the merger to satisfy the causation requirement. See *Laurenzano* v. *Einbender*, 264 F. Supp. 356 (E.D. N.Y), and the quotation therefrom in n. 14, *infra*.

[14] It has been said that, even where the controlling person has sufficient stock to vote to effect the merger, "[i]t is not * * * to be assumed without evidence that the solicitation of proxies was a gratuitous and, therefore, purposeless and legally

effectuate the underlying purposes of the proxy rules—fair disclosure to shareholders when their votes are solicited.

2. We agree with the court of appeals, however, that the issue of fairness of the terms of the merger may be important—but as relevant to the question of relief, rather than as a complete defense to the cause of action.

It does not follow from the fact that the merger may have been brought about by misleading proxy material that it should necessarily be undone in an attempt to restore the *status quo*. The combined entity is not inherently unlawful, as it would be, for example, if the combination had been found to violate the antitrust laws; and in some instances attempts to unscramble the holdings in the corporate entities could be harmful to innocent third parties (who may have purchased or retained shares in the com-

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inert act." *Laurenzano* v. *Einbender*, *supra*, 264 F. Supp. at 361. The court in that case continued:

> It may be that an unfavorable vote from the minority stockholders would have brought about modification or reconsideration of the transactions; in corporate circles, consensus can be a desideratum. It may be that a value was perceived and sought in just such a favorable vote as was obtained from the one-quarter of the minority stockholders who mailed in their proxies. Such seemingly pointless approbations have their uses, and even the record of disclosure itself may serve a range of useful purposes. * * *

But cf. *Robbins* v. *Banner Industries, Inc.*, CCH Fed. Sec. L. Rep. ¶91,861 at 95,952–95,953 (S.D. N.Y., December 21, 1966), where the court pointed out that "[t]here is no insurer liability under section 14(a); the alleged violation of the proxy rules does not give [rise] to a cause of action under this section unless there is some causal connection between the violation and the injury."

bined entity in reliance on the seemingly valid merger) or, indeed, to the very class of persons who were misled.

Nor do we agree with petitioners' contention that Section 29(b) of the Securities Exchange Act of 1934 (*supra*, p. 3), which declares contracts made or performed in violation of the Act or a rule thereunder to be "void * * * as regards the rights of" the violator and knowing successors in interest, automatically requires that the merger be set aside because the merger agreement is a "void" contract. We recognize that the merger agreement is a "contract made [or performed] in violation of" the Act, and a rule thereunder, within the meaning of Section 29(b), but we believe that, properly interpreted, that Section—which declares such contracts to be "void" only as against the rights of certain persons—basically means that such a contract is voidable at the option of the innocent party thereto rather than necessarily a nullity even if the innocent victim of the violation wishes to enforce his rights under the contract. As the court of appeals for the Eighth Circuit explained in *Greater Iowa Corp.* v. *McLendon*, 378 F. 2d 783, 792:

> * * * Subsection (1) only declares to be void the rights of any person who violates the provisions of the statute. The contract rights of the party not in violation are in no way impaired. Bankers Life and Casualty Company v. Bellanca Corporation, 288 F. 2d 784, 787 (7 Cir. 1961), cert. denied 368 U.S. 827 * * *. Though § 29(b) speaks in terms of "void" and the guilty party is clearly precluded from enforcing the contract against an unwilling innocent party,

> just as clearly the innocent party is left free to enforce the contract if he so desires. This being true the contract cannot possibly be considered absolutely and totally void. It is a contract "voidable" at the option of the innocent party. Royal Air Properties, Inc., v. Smith, 312 F. 2d 210, 213 (9 Cir. 1962). If this contract is "voidable," or void only at the option of the innocent party, the contract must be considered valid until voided by the party having the right of recision. * * *

In the present case, because the plaintiffs are not themselves parties to the merger agreement, they do not enjoy the unqualified statutory right of an innocent party to the contract to have it set aside under Section 29(b) (although, as innocent victims of the proxy violation, they presumably would have the right to rescind their own proxies if they had been submitted in favor of the merger in response to the unlawful solicitation). And, to the extent that the plaintiffs in their representative capacity stand in the shoes of Auto-Lite as a party to the merger agreement, it is far from certain that the shareholders the plaintiffs represent would wish to have the merger set aside. We believe, therefore, that the proper meaning of Section 29(b) in the context of a suit such as the present one is that the contract of merger entered into as a result of the proxy violation is voidable, but should be set aside only if a court of equity concludes, in all the circumstances, that it would be equitable to do so.

It also does not follow from the mere fact of the proxy violation that the stockholders whose proxies were wrongfully solicited are necessarily entitled to

substantial monetary relief, whether or not it might be appropriate for the merger to be undone. If stockholders were misled as to the specific terms of the merger, there should be an accounting so that they would receive that which was represented to them in terms of value. But where, as here, the misleading aspect of the solicitation did not relate to the terms of the merger, the misled stockholders should be entitled to monetary or other relief only if the merger resulted in a reduction to them of earnings or earnings potential. That is, stockholders whose company was merged on the basis of materially misleading proxy solicitations are entitled to recover damages resulting from such merger to the extent that such damages can be shown, as may be possible where assets and operations of the merged companies remain separate. And monetary relief would, of course, be inappropriate where it could be shown that the complaining stockholders were receiving greater earnings or earnings potential than would have been the case had the companies remained separate.

To establish direct injury resulting from the merger in the foregoing manner would normally be impossible in cases in which the assets and operations of the combined companies have been intermingled. A determination of whether the terms of the merger had been fair would then appear to be the proper basis for deciding what relief is warranted. If the merger were found to be unfair at the time it was consummated, it could then be determined what relief would be appropriate to make whole the misled stockholders. Consideration should be given, for example, to attempt-

ing to determine what would have been a fair exchange ratio as contrasted with that involved in the merger, and of awarding minority stockholders whose proxies were wrongfully solicited cash damages or additional stock in the merged company sufficient to make their treatment fair. If, on the other hand, the merger terms were found to have been fair, there would presumably be no damages payable or accounting required to those who have been misled, although in appropriate circumstances injunctive relief might be suitable. These, of course, are questions to be decided by the district court on remand.

II. VIOLATION OF THE COMMISSION'S PROXY RULES SHOULD ENTITLE THE PLAINTIFFS TO AN AWARD OF REASONABLE LITIGATION EXPENSES, INCLUDING ATTORNEYS' FEES, BOTH IN ESTABLISHING THE VIOLATION AND IN ATTEMPTING TO SHOW UNFAIRNESS OF THE MERGER

If, as we have contended, the finding of a proxy violation established the plaintiffs' cause of action, the court of appeals should have affirmed the judgment in plaintiffs' favor, with modification of the district court's reference of the case to a special master, if this was inappropriate. The costs of the appeal would, in that event, have been borne by the defendants.

Similarly, in our view, the plaintiffs, who have established a violation of the securities laws by their corporation and its officials, are entitled to litigation expenses and reasonable attorneys' fees (1) to enable them to go forward with the trial on the issue of appropriate relief and (2) for their efforts in establishing the violation.

Where, as here, prolonged litigation might be required to determine whether a corporation's violation has resulted in unfairness to its stockholders, it is inequitable for the stockholders who have established the violation to be required to bear the expenses of further litigation. It is appropriate, instead, that the corporation (or the entity into which it has merged) bear the expenses of presenting to the court the issue of whether injury resulted and, if so, the determination of proper relief, as well as the expenses that the stockholders have already incurred in order to establish the violation.

The court below held that the burden of persuasion regarding the fairness of the merger has shifted to those shown to have violated the securities laws, but this is scarcely adequate interim relief for the stockholders who have established the violation. Because it is common for corporations planning a merger to hire experts to assess its fairness, it should not be difficult in most cases for the defendants to meet the initial burden by producing the studies and testimony of these experts. The plaintiffs would then be required to offset the evidence of defendants' expert witnesses. This would require them to engage their own expert witnesses, to make audits and investigations of the books and records of the defendants, to take depositions, and to carry on a full-dress trial.

These expenses of proving the plaintiff-stockholders' case are incurred for the benefit of their corporation because there was "deceit practiced on the stockholders as a group." *J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 432. Certainly, if plaintiffs are able to

show that the plan was unfair to Auto-Lite or its shareholders and that the merger should be dissolved or other relief awarded, there would be a direct financial benefit. Accordingly, plaintiffs' subsequent litigation expenses, including reasonable attorneys' fees (reflecting, among other things, the ultimate benefit, or lack thereof, of the litigation to the corporation or the stockholders as a group), should be borne by their corporation (or the corporation into which it has merged). To eliminate possible abuse, however, it might be appropriate to require the plaintiffs, in order to qualify for reimbursement of their subsequent litigation expenses, to make a preliminary showing of a substantial possibility that the defendants' proof of fairness might be successfully controverted.[15]

For the same reasons, the plaintiffs are even more clearly entitled to reimbursement of their expenses already incurred, including reasonable interim attorneys' fees, in establishing the violation. "[I]n causes like these which involve corporate therapeutics,"[16] attorneys' fees may be awarded notwithstanding the absence of express statutory authorization therefor. For example, in *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231, 241 (C.A. 2), certiorari denied, 320 U.S. 751, the plaintiff shareholders were awarded attorneys' fees for their recovery of short-swing profits under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b), even though recovery of attorneys'

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[15] Cf. *Dolgow* v. *Anderson*, 43 F.R.D. 472, 501–503 (E.D. N.Y.).

[16] *Murphy* v. *North American Light and Power Co.*, 33 F. Supp. 567, 570 (S.D. N.Y.).

fees is not expressely provided for in Section 16(b) and is expressly provided for in two unrelated sections of the same statute.[17] The court relied on the long recognized principle that "a stockholder who is successful in maintaining * * * an action [for his corporation's benefit which it has been unwilling to institute] is entitled to reimbursement for reasonable attorney's fees on the theory that the corporation which has received the benefit of the attorney's services should pay the reasonable value thereof." 136 F. 2d at 241.[18]

Award of attorneys' fees has been deemed appropriate even where no fund at all may be produced by the litigation. For example, in reorganization cases under Chapter X of the Bankruptcy Act, 11 U.S.C. 501, *et seq.*, attorneys' fees are awarded for various activities considered beneficial to the debtor's estate, such as opposition to a plan not meeting the statutory standards.[19]

If "benefit" to the corporation be the test of whether it is equitable to award attorneys' fees, benefit must

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[17] See Sections 9(e) and 18(a) of the Securities Exchange Act, 15 U.S.C. 78i(e) and 78r(a), respectively.

[18] See, generally, *Trustees* v. *Greenough*, 105 U.S. 527; *Sprague* v. *Ticonic National Bank*, 307 U.S. 161. See, also, *Maggiore* v. *Bradford*, 310 F. 2d 519 (C.A. 6); cases cited in Hornstein, *Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards*, 69 Harv. L. Rev. 658, 675–679; and in Hornstein, *New Aspects of Stockholders' Derivative Suits*, 47 Colum. L. Rev. 1, 24–28. Cf. *Bakery and Confectionary International Union* v. *Ratner*, 335 F. 2d 691 (C.A. D.C.).

[19] See Sections 241–246, 248 and 249 of the Bankruptcy Act, 11 U.S.C. 641–646, 648 and 649, respectively; 6A Collier, *Bankruptcy* ¶ 13.02 at 914–915, ¶ 13.06 at 954, ¶ 13.12 at 981, ¶ 13.14 at 994 nn. 14, 15 (14th ed. 1968). See, *e.g.*, *Scribner & Miller* v. *Conway*, 238 F. 2d 905, 907 (C.A. 2); *In re Consolidated*

be calculated in the light of the statutory policy requiring fair disclosure in the solicitation of proxies. If, for example, it had been feasible to try the issue of violation in the present case prior to the meeting at which the votes were cast, the plaintiffs surely would have been entitled to attorneys' fees even if the stockholders later voted to approve the merger after a proper resolicitation of their proxies. The fact that, as we urged in point I, it may no longer be practical or equitable to set aside the merger does not compel denial of a fee; the stockholders will here be benefited by obtaining judicial scrutiny of the fairness of the plan as a substitute for a properly informed vote of the stockholders.

This Court has noted that "Private enforcement of the proxy rules provides a necessary supplement to Commission action." *J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 432; cf. *Smolowe* v. *Delendo Corp., supra,* 136 F. 2d at 241; *Blau* v. *Rayette-Faberge, Inc.,* 389 F. 2d 469, 472 (C. A. 2); *Gilson* v. *Chock Full O'Nuts Corp.,* 331 F. 2d 107, 110 (C.A. 2). It provides an important deterent to unlawful proxy solicitation by corporate management. Such enforcement will be dis-

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Motor Parts, Inc., 85 F. 2d 579, 581 (C.A. 2); *In re Midland United Co.*, 64 F. Supp. 399, 410 (D. Del.), affirmed on other grounds, 159 F. 2d 340 (C.A. 3). Cf. *Abrams* v. *Textile Realty Corp.*, 97 N.Y.S. 2d 492, 496 (Sup. Ct.):

> [O]n the narrow issue of law as to "the right" to an allowance [of attorney's fees], * * * there is no relevance in an argument that this suit created no fund or property for [the defendant corporation] or its security holders, or that they or any of them would have been better off if the *ultra vires* act had been performed. The law cannot refuse to recognize as beneficial full observance of the law.

couraged if interim relief such as suggested herein is unavailable after a violation has been established. The court in *Smolowe, supra,* 136 F. 2d at 241, noted that the "possibility of recovering attorney's fees" may "provide the sole stimulus" for a shareholder to initiate an action challenging questionable corporate activities. And a perceptive commentator summed up the need for reimbursement of litigation expenses as follows:[20]

> If reimbursement were not permitted to a stockholder successfully prosecuting a suit to redress a wrong to his corporation, the practical effect would be the same as if the suits were prohibited and the small stockholder remediless, for the expenses in most cases would exceed the increase in the value of his stock, resulting in a net loss to him individually even if he were successful in recovering for the corporation. * * *

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[20] Hornstein, *The Counsel Fee in Stockholder's Derivative Suits*, 39 Colum. L. Rev. 784, 791. See, also, Hornstein, *Legal Therapeutics: The "Salvage" Factor in Counsel Fee Awards*, 69 Harv. L. Rev. 658, 663.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be modified in accordance with the views expressed in this brief.

Respectfully submitted.

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